

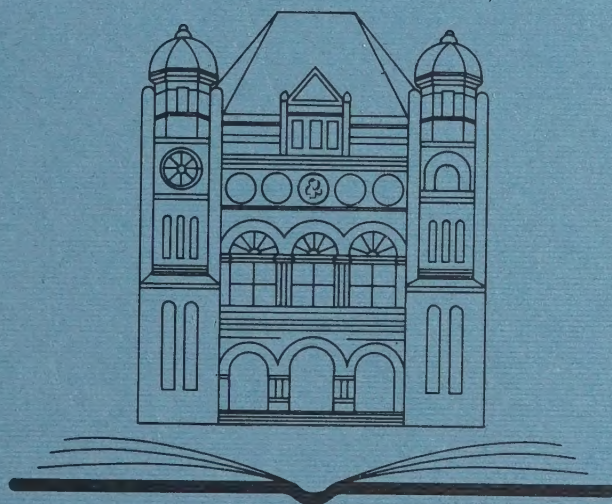
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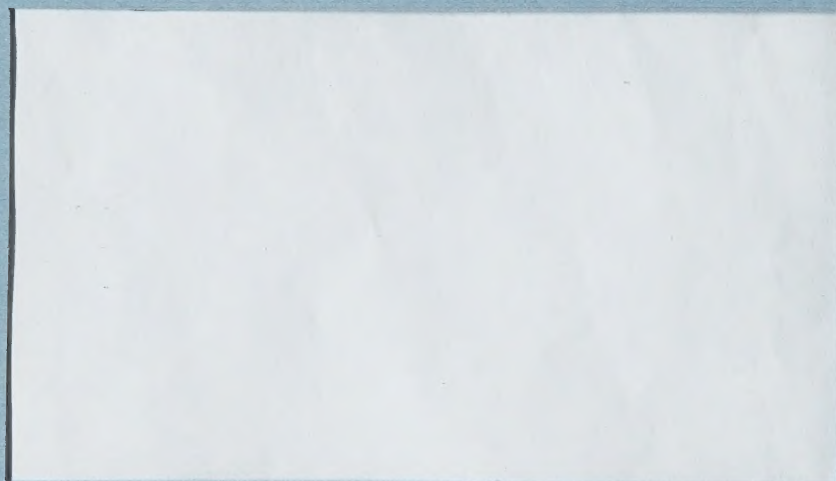
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THE RECENT ROUND OF CANADA
PENSION PLAN NEGOTIATIONS

Ted Glenn
Research Officer



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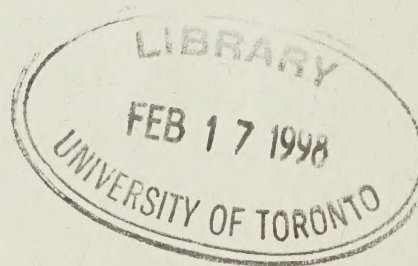
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INTRODUCTION

As the bulk of baby boomers move closer to retirement, governments and citizens are beginning to wonder if there will be enough money left in the Canada Pension Plan for their retirement, let alone for younger generations. Federal and provincial governments recently grappled with this problem in a series of negotiations over CPP reform.

This paper briefly explains how the Canada Pension Plan operates and then provides some background information on recent proposals for reform. The paper concludes by providing a chronology of the 1996-97 round of federal-provincial negotiations on reform.

THE CANADA PENSION PLAN

The Canada Pension Plan (CPP) is a “pay-as-you-go” system, meaning that the current working generation supports the pensions of the current retired generation. At present, about 10 million working Canadians and their employers contribute to the CPP. About \$12.5 billion in contributions will be added to the fund in 1996 and these contributions, along with interest earned on the fund, will provide approximately \$7.5 billion in retirement, disability and survivor benefits.

In 1996, employers and employees each contributed 2.8 % (for a total of 5.6 %) of each employee’s salary, up to the Yearly Maximum Pensionable Earnings (YMPE), which is currently set at \$35,400. The YMPE is estimated to represent the average income of Canadians. Employers and employees do not make CPP contributions if their earnings are less than the Yearly Basic Exemption (YBE) amount, which was \$3,500 in 1996.

CPP retirement benefits are calculated according to: the number of years worked and contributing to the Plan; and the average salary or wages earned in the past three years before retirement. Individuals are currently allowed to drop from their earnings record 15% of their non-working or low-income years between the age of 18 and 65, to a maximum of 7 years. In 1996, the maximum pension for a person age 65 was \$713.17 per month, or \$8,558 per year. Other benefits currently available under the CPP plan include survivor benefits, death benefits, and disability benefits.

THE CPP REVIEW PROCESS

The CPP contribution rate schedule, which establishes rates for the next 25 years, is reviewed by the provincial, territorial and federal governments every five years to ensure that there is enough money in the benefit fund to pay all current benefits, plus two years of reserve funding. Major changes to the CPP, including changes

to the 25-year contribution rate schedule, require the approval of the Parliament of Canada and the governments of at least two-thirds of the provinces representing two-thirds of Canada's population.

The 1996 review, which was initiated in February, focused on the costs of pension benefits which are expected to rise as the "baby boom" generation enters retirement age. When the CPP was originally designed in 1966, contributions were not expected to rise above 5.5 % of an individual's earnings. To account for demographic changes, however, contribution rates have already been legislated to reach 10.1 % by the year 2016.

CPP contributions are estimated to rise to 14.2 % in 2030 if the system is not reformed. The following table summarizes the component costs of this expected increase.

Projected Costs	Impact on Required Contributions
Change in demographics (due to lower birth and death rates and increased life expectancies)	+2.6%
Change in economics (due to slower growth in output per worker)	+2.2%
Enrichment of benefits (including full indexing of benefits, payment of survivor benefits and the elimination of the retirement and earnings test)	+2.4%
Disability (due to increased disability benefits claimants)	+1.5%
Costs in 2030 as now projected	+14.2%

Source: Chief Actuary of the CPP

OPTIONS FOR REFORM

This section outlines many of the options for Canada Pension Plan reform which were circulated during the 1996 review process.¹ It does not analyze their pros and cons, but is simply intended to highlight the proposals on the table in recent negotiations.

Qualifications

To calculate lifetime earnings, contributors are currently allowed to drop from their earnings record 15% of their non-working or low-income years between the ages of 18 and 65, to a maximum seven years. By reducing this low-earnings exemption to 10%, overall CPP costs could be reduced by 2.2%, which is equivalent to a reduction of 0.31% of individual and employer contribution rates.

Another way to achieve savings is to raise the age of entitlement from the current 65 years to 67 years. This measure could reduce overall CPP costs by 4.2%, equivalent to a 0.63% decrease in required contributions. If the age of entitlement were raised, rules governing partial pensions (which would allow older workers to receive a partial pension and work part-time) could be adopted to help offset the lower income from reduced employment.

Qualification Reform Options	% Decrease in CPP Expenditures	% Decrease in Contributions
Increase contribution period	-2.2%	0.31%
Raise age of entitlement	4.2%	0.63%

Source: Canada, Department of Finance, *An Information Paper for Consultations on the Canada Pension Plan* (Ottawa: The Department, 1996).

Disability Benefits

At present, individuals are entitled to receive disability benefits (which are indexed to the consumer price index to account for the effects of inflation) as long as they meet the CPP disability definition. At age 65, disability benefits are automatically converted to a retirement pension. There are at least two ways to reduce the costs associated with providing a pension benefit which does not reflect lifetime earnings. First, disability pensions could be linked to maximum pensionable earnings at the time of disablement to reflect better the work history of the individual; this could reduce CPP expenditures by 1.1%, or 0.15% in required contributions. Second, disability pensions could be actuarially-reduced at age 65 to treat disabled persons at retirement commensurate with those who take early retirement at age 60 (which was first allowed in 1987). This could reduce CPP expenditures by 2.7%, or 0.39% in contribution rates.

Another way to achieve savings on disability benefits is to tighten the eligibility requirements. Currently, individuals must have contributed to the Plan in two of the last three calendar years or five of the last ten calendar years before applying for disability benefits. By increasing the eligibility period to four of the last six years, CPP expenditures could be reduced by 1.2%, or 0.17% in contribution rates.

Disability Benefit Reform Options	% Decrease in CPP Expenditures	% Decrease in Contributions
Reduce disability benefit conversion	1.1%	0.15%
Actuarially reduce disability benefit	2.7%	0.39%
Tighten eligibility requirements	1.2%	0.17%

Source: Canada, Department of Finance, *An Information Paper for Consultations on the Canada Pension Plan* (Ottawa: The Department, 1996).

Retirement Benefits

There are a number of cost savings measures which could be achieved vis-à-vis retirement benefits. One is to reduce retirement benefits for *new* retirees from the current 25% of life-time earnings to 22.5%. This measure would reduce CPP costs by 8.8% overall, or 1.25% in contribution rates.

Another option is to reduce the level of pension benefit indexation to the rate of inflation minus one percent. At present, benefits are matched to increases in inflation directly. This measure could reduce CPP expenditures by 9.0%, or 1.28% in contribution rates.

In some provinces, disabled persons receive both CPP and Workers' Compensation benefits. By reducing CPP benefit pay-outs to take account of WC benefits (which is known as "stacking" CPP and WC benefits), 0.6% of CPP expenditures could be saved, or 0.08% in required contributions.

A fourth way to reduce pension benefit costs is to reduce survivor benefits. At present, a ceiling exists on the amount of combined benefits that an individual can receive from disability, retirement and survivor benefits. A new ceiling could be set at the level of the maximum disability pension alone, or a formula could provide only a portion of the two earnings-related amounts. Either change could reduce CPP costs by 1.2%, or 0.17% in contribution rates.

Finally, death benefits could be eliminated. The current plan provides a one-time death benefit worth \$3,540 to the estate of the deceased contributor or pensioner to help defray funeral costs. When it was initially created, the death benefit was justified on the grounds that most retiring couples were single-income couples and could ill-afford the costs of a funeral. With more and more two-income couples retiring, it can be argued that the benefit could be eliminated, saving 1.5% of overall CPP costs, or 0.21% in contribution rates.

Retirement Benefit Reform Options	% Decrease in CPP Expenditures	% Decrease in Contributions
Reduce benefits	8.8%	1.25%
Reduce level of indexing	9.0%	1.28%
Stack CPP and WC benefits	0.6%	0.08%
Tighten survivor benefits rules	1.2%	0.17%
Eliminate death benefit	1.5%	0.21%

Source: Canada, Department of Finance, *An Information Paper for Consultations on the Canada Pension Plan* (Ottawa: The Department, 1996).

Changes to the YMPE

Currently, employers and employees are exempted from paying contributions on the first 10% of the Yearly Maximum Pensionable Earnings (YMPE), although benefits are paid on these earnings. While this exemption provides for some progressivity (i.e., lower income earners are exempted from contributions on a larger proportion of their earnings than are higher income earners), one effect of the exemption is to make contribution rates higher than they otherwise would be. Reducing the exemption level to 5% of insured earnings could reduce the overall CPP contribution rate by 1.1%.

The National Council on Welfare has recommended raising the ceiling on the YMPE so that pension benefits can be maintained at their current level, or even possibly increased.² According to the Council, any increase in the YMPE would cause the burden of contributions to be redistributed as “workers with total earnings up to the YMPE and their employers would pay less in CPP contributions...[and w]orkers who earned more than the current YMPE and their employers would pay more.”³ The following table summarizes the effects of increasing the YMPE:

Effect of Changes to Yearly Maximum Pensionable Earnings

Options	Contribution at YMPE	Changes in Contribution
<i>Current</i> Contribution Rate= 6.95% YMPE=\$35,400 with 10% exemption	\$2,219	
<i>Proposed</i> Contribution Rate= 5.28% without 10% exemption With current YMPE (\$35,400)	\$1,684	-\$534
<i>Proposed</i> Contribution Rate= 5.28% without 10% exemption 1.5xYMPE (\$53,100)	\$2,619	+\$400
<i>Proposed</i> Contribution Rate= 5.28% without 10% exemption 2xYMPE (\$70,800)	\$3,553	+\$1,335

Source: National Council of Welfare, *Improving the Canada Pension Plan* (Ottawa: Minister of Supply and Services, 1996), p.15.

The National Council on Welfare suggests that the savings achieved by doubling the YMPE be put toward increasing CPP retirement benefits according to a two-stage formula. Known as the *Cofirentes+* formula, CPP benefits would equal 50 % of an individual's earnings up to *half* the average wage, and 25 % of earnings thereafter up to the average wage. This formula would provide for a pension benefit equivalent to 37.5 % of the average wage, instead of the current level of 25 %. By way of comparison, the U.S. Social Security programme provides a retirement benefit worth 42 % of earnings at the average wage.⁴

The following table compares retirement benefits for seniors who earned half the average wage under the current CPP schedule and the *Cofirentes+* formula:

	Single Person Benefits		Couple Benefits	
	Current	Cofirentes+	Current	Cofirentes+
CPP Income	\$4,279	\$8,558	\$4,279	\$8,558
Old Age Security	\$4,690	\$4,690	\$9,381	\$9,381
Guaranteed Income Supplement	\$3,498	\$1,410	\$5,197	\$3,109
Total Income	\$12,467	\$14,658	\$18,857	\$21,049

Source: National Council of Welfare, *Improving the Canada Pension Plan* (Ottawa: Minister of Supply and Services, 1996), p.21.

The following table summarizes the CPP contributions which would be required to pay for the Cofirentes+ proposal, including rates which would be required if the YMPE were doubled as per the Council's recommendations:

Year	Rates Required to pay Current CPP Benefits	Rates Required to pay for Cofirentes+ Benefits	Rates to pay for Cofirentes+ with YMPE doubled
2000	7.16	7.48	6.36
2005	8.87	9.67	7.51
2010	10.28	11.82	8.87
2015	11.55	14.01	10.43
2020	12.60	16.21	12.15
2025	13.40	18.29	13.82
2030	13.91	20.06	15.27

National Council of Welfare, *Improving the Canada Pension Plan* (Ottawa: Minister of Supply and Services, 1996), p.23.

Steady-state Financing

Another way to equalize the costs of the CPP is to raise contributions to a higher level (i.e., 12%) which can be maintained without any further increases. This would create, in effect, a "steady-state" contribution rate. This higher rate would increase the size of the reserve fund to about \$120 billion, providing a major investment source to lower contribution rates in the future.

The following table summarizes the savings which steady-state financing could achieve by the year 2030 in conjunction with other savings strategies:

Benefits Scenario	Steady-state Contribution Rate (%)
Proposed Steady-state Plan alone	12.2%
In conjunction with other reform initiatives which achieve:	
7% reduction in contribution rates	11.3%
10% reduction in contribution rates	10.9%
15% reduction in contribution rates	10.3%

Source: Canada, Department of Finance, *An Information Paper for Consultations on the Canada Pension Plan* (Ottawa: The Department, 1996).

THE 1996 CPP NEGOTIATIONS

In June 1996, Canada's finance ministers agreed that the current "pay-as-you-go" system was not financially sustainable in the long-term. They agreed in principle to raise contributions from the current level of 5.6% to around 10% over the next six to eight years. The finance ministers agreed to delay discussions about other reform issues, such as raising the age of entitlement and reforming survivor and death benefits, until the next round of meetings, scheduled for mid-October.

Two weeks prior to the October meeting, Andrew Petter, British Columbia's Finance Minister, announced that he would be seeking to expand rather than reduce CPP benefits to the disabled and the poor. Mr. Petter's proposal was based on the National Council on Welfare's recommendations outlined above.⁵ While Petter agreed that contributions would have to increase to account for demographic and economic changes, he argued that the burden of contributions should be spread more evenly and that pension benefits could, as a result, be maintained or even expanded. Saskatchewan's Finance Minister, Janice McKinnon, said that her province would support B.C.'s proposal.

BC was not the only province to make its bargaining stance known prior to the October meeting. Ontario's Finance Minister, Ernie Eves, announced that he would support an increase in CPP premiums only if unemployment contributions were reduced by an equal amount.⁶ Beyond press reports, there are no formal documents outlining Eves' proposal.

At the close of the October meeting, Canada's finance ministers issued a declaration entitled "Principles to Guide Federal-provincial Decisions on the Canada Pension Plan." The document summarized the key points which the finance ministers were able to agree on, including:

- increasing the CPP contribution rate to 10.1%;

- reforming the administration of the CPP; and
- investing CPP funds in order to maintain a proper balance between returns and investment risk.

There was no agreement on other aspects of CPP reform, including the time period over which the contribution rate would be increased to 10.1%. According to media reports, there were two obstacles to any consensus on these issues. First was Ontario's insistence that increased CPP contributions be accompanied by reduced UI premiums.⁷ Mr. Eves reportedly had the support of finance ministers from Quebec, British Columbia, Alberta, Manitoba and Saskatchewan, (which together, incidentally, represent over two-thirds of the Canadian population). The second obstacle was BC and Saskatchewan's "controversial alternative plan to protect benefits by lifting the ceiling on the amount of income against which the CPP levy is applied."⁸

The finance ministers agreed to hold another round of CPP reform negotiations before the end of 1996. Because of the obstacles noted above, the negotiations were delayed until February 1997, federal Finance Minister Paul Martin agreed to reduce UI premiums by \$0.10 on every \$100 of insurable earnings, to take effect January 1, 1998.⁹ This commitment was quickly followed by the introduction of legislation into the House of Commons to implement the following changes to the CPP:

CPP Component	Current Plan	Proposed Changes
Investment policy	Funds invested in non-negotiable provincial bonds	New funds invested in a diversified portfolio of securities
Contribution rates	Rising to 10.1% by 2016, 14.2% by 2030	Rising to 9.9% by 2003, then capped
Benefits for new retirees	Based on the average of last three years' YMPE	Based on the average of last 5 years' YMPE
Eligibility for disability benefits	Must work and contribute in 2 of the last 3 or 5 of that last 10 years	Must work and contribute in 4 of last 6 years
Disability benefits	Based on average of the last three years' YMPE when recipient turns 65, then indexed to inflation	Based on average of the last five years' YMPE prior to date of disablement and indexed to inflation
Combined survivor-disability benefits	Ceiling is equal to maximum retirement benefit plus larger of two flat-rate components	Ceiling is one maximum disability benefit
Death benefit	Currently \$3,540, indexed to inflation	Capped at \$2,500, not indexed

Source: Canada, Department of Finance, *Securing the Canada Pension Plan: Agreement on Proposed Changes to the CPP* <<http://www.cpp-rpc.gc.ca/sec/secure.htm>> (8 August 1997).

Other reform initiatives, such as reducing the Yearly Basic Exemption and “stacking” pensions and other benefits, were not acted upon at this time.

The provinces have until January 1, 1998 to concur with the legislation by passing orders in council agreeing to the changes. So far, Newfoundland, Nova Scotia, New Brunswick, Prince Edward Island, Quebec, Ontario, Manitoba and Alberta have agreed to do so.

NOTES

¹ Unless otherwise indicated, all proposals are derived from Canada, Department of Finance, *An Information Paper for Consultations on the Canada Pension Plan* (Ottawa: The Department, 1996). This document was released in February 1996, by the federal, provincial and territorial governments to guide the 1996 review process.

² On the relationship between Petter's plan and the paper by the National Welfare Council see Peter O'Neil, "BC's Pension-plan Proposal Gains Support," *Vancouver Sun*, 25 September 1996, p. A6.

³ National Council of Welfare, *Improving the Canada Pension Plan* (Ottawa: Minister of Supply and Services, 1996), p. 14.

⁴ *Ibid.*, p. 18.

⁵ See John Geddes, "Martin's consensus quest," *The Financial Post*, 4 October 1996; and Shawn McCarthy, "Part-time fears hit from reform of pension plan," *Toronto Star*, 4 October 1996, p. C1.

⁶ Geddes and McCarthy.

⁷ See Shawn McCarthy, "Governments hit CPP logjam," *Toronto Star*, 5 October 1996, p. A32; John Geddes, "Plan for CPP reform stalls," *The Financial Post*, 5 October 1996, p. 1; and Barrie McKenna, "Provinces block CPP reform," *Globe and Mail*, 5 October 1996, p. A1.

⁸ *Ibid.*

⁹ Edward Greenspon, "Martin strikes CPP deal," *Globe & Mail*, 14 February 1997, p. A1; and Shawn McCarthy, "Ottawa, Ontario each claim victory with changes to CPP," *Toronto Star*, 17 February 1997, p. A10.



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